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No. 673

In the Supreme Court of the United States

October Term, 1958

JOHN M. WINTERS, JR., and MARIAN M. WINTERS,
Petitioners,
vs.
UNITED STATES OF AMERICA, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT.

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vs.

UNITED STATES OF AMERICA, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit entered in the above-entitled case on November 13, 1958.

Citations to Opinions Below.

The opinion of the District Court (Findings of Fact and Conclusions of Law) is unreported and is printed in Appendix A herein, *infra*, p. 10. The opinion of the Circuit Court of Appeals, printed in Appendix B hereto, *infra* p. 14, is still unreported.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on November 13, 1958, *infra*, p. 14. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1).

Question Presented.

Whether the cost of whiskey bought and used in Oklahoma by a lawyer for the entertainment of clients and prospective clients of the law firm in which he was a member is deductible as an ordinary and necessary business expense within the meaning of Section 162(a) of the Internal Revenue Code of 1954.

Statute Involved.

The statutory provision involved is Section 162(a) of the Internal Revenue Code of 1954. Also involved are certain liquor laws in force in the State of Oklahoma. These are printed in Appendix C, *infra*, p. 29.

Statement.

In their 1954 joint income tax return, petitioners John M. Winters, Jr., a Tulsa lawyer, and his wife, claimed as a deductible expense $301.75 spent for approximately four cases of whiskey delivered to their home in Tulsa and used there for entertainment which the trial court found appropriate and helpful in the retention and development of Mr. Winters' law business. The trial court found that it is the "usual practice in the City of Tulsa and in the State of Oklahoma for attorneys-at-law in the general practice to furnish liquor in connection with the entertainment of clients and prospective clients." Acting pursuant to

Rev. Rul. 55-307 1955-1, Cum. Bull. 22, the Treasury disallowed the claimed deductions. Petitioners paid the additional tax and timely filed a claim for refund of such additional tax and interest. After denial of the refund claim petitioners filed this action in the United States District Court for the Northern District of Oklahoma pursuant to 26 U. S. C., Sec. 1346 for the refund of the taxes and interest represented by the disallowed deductions.[1] The District Court found that Rev. Rul. 55-307, which had been the basis of the disallowance of petitioners' claim, was erroneous in concluding that expenditures for liquor purchased in Oklahoma for business promotion and entertainment purposes are not deductible expenses, and finding that such expenditures were otherwise deductible as ordinary and necessary business expenses, entered judgment for petitioners. The United States Court of Appeals for the Tenth Circuit, by a divided court, reversed this judgment, holding that although the expenses were ordinary and necessary business expenses they should not be allowed because the allowance would frustrate the public policies of the State of Oklahoma expressed in its liquor laws.

Reasons for Granting the Writ.

The question presented is of substantial importance in the Administration of the Internal Revenue Code. It affects a very large number of taxpayers. The action of the

1. The suit also involved a claim for refund of taxes paid by petitioners in connection with the disallowance of a casualty loss for shrubs and trees damaged by drouth. Petitioners were successful on this claim and the Government did not pursue this feature of the case in the Court of Appeals.

Commissioner in disallowing the deduction in this case was predicated upon Rev. Rul. 55-307 which when promulgated on May 23, 1955, represented the first attempt of the Commissioner to challenge deductions of this nature and prompted widespread editorial comment throughout the State of Oklahoma. This case has from the beginning been considered as an important test case under this Revenue Ruling and the District Court recognized it as such.[2]

Had the Government lost this case in the Court of Appeals it would have petitioned for certiorari on the basis of the amount of revenue involved, the number of taxpayers affected and the general importance of the question. The fact that, of the four judges who have heard the case thus far, two have ruled in favor of petitioners and two for the Government, establishes that the question presented is fairly debatable. Petitioners do not, in this petition, argue the question involved on the merits but confine their statement to a showing of the importance of review by this Court.

Moreover, the decision affects a large number of taxpayers in the State of Oklahoma. Aside from the undisputed finding of fact of the District Court that "it is the usual practice in the City of Tulsa and in the State of Oklahoma for attorneys-at-law in the general practice to

2. In commenting on the time spent by Government counsel in connection with an unrelated casualty loss claim the Court stated, "I say, let's move along; we have a jury waiting in the court room to try a jury case; costs more money than the tax involved on this shrubbery; now let's don't take too much time. The other item is a test case *and is quite important.*" (Emphasis added.) (R. 18.)

furnish liquor in connection with the entertainment of clients and prospective clients," (*infra*, p. 10) attorneys-at-law are by no means the only group of people in the State who find it customary and necessary to furnish liquor in the entertainment of clients and customers. The dissenting opinion in the Court of Appeals by Judge MURRAH, a long-time resident of Oklahoma, is vivid testimony that the practice is not unusual.

The significance of this case is highlighted by the novel nature of the holding of the Court of Appeals that the allowance of this deduction would frustrate the public policy of the State of Oklahoma because Mr. Winters' guests were his clients and prospective clients, although no public policy of the State would be frustrated if his guests were purely social guests. This holding is indeed novel and turns upon a distinction not found in any decision of the Oklahoma courts or any other expression of the public policy of Oklahoma. Indeed, while the Income Tax Laws of the State of Oklahoma have since 1933 contained provisions allowing as deductions from gross income "all the ordinary and necessary expenses paid during the taxable year in carrying on any trade or business, or in the production of income * * *" (Oklahoma Session Laws 1935, Ch. 66, p. 291, 68 Okla. Stat. Anno. Sec. 880 (a)) and the liquor laws of the State have remained substantially unchanged since that time, no decision can be found where the taxing authorities of the State have questioned deductions of this nature on the ground of repugnance to the public policies of the State.

While it may seem unusual to the Court that the possession and consumption of liquor by a resident of the State of Oklahoma and the sharing of liquor in his own home with his guests are not illegal, both the District Court and The Court of Appeals have clearly agreed that this is the law of Oklahoma. In fact the right of citizens of the State of Oklahoma to have liquor in their possession in their homes was recognized by the Crimmal Court of Appeals of the State of Oklahoma when, in *Ex parte Wilson*, 6 Okl. Cr. 451, 119 Pac. 596 (1911), it held unconstitutional a State statute which prohibited the keeping of more than one quart of liquor in clubs, places of business, etc., "whether such liquors be intended for personal use of the person so having and keeping the same or not."

In this case the Court of Appeals for the Tenth Circuit held that while the furnishing of liquor to *social* guests in one's home does not frustrate the public policy of the State of Oklahoma, the furnishing of liquor in one's home to guests who may be clients or prospective clients of the host does frustrate the State's public policy. Support is drawn for this conclusion solely from *Dawson* v. *State*, 273 P. 2d 154 (Okl. Cr. 1954), but that case actually held that possession of a quantity of liquor for the purpose of "bartering" the same was unlawful. The opinion of the Court in that very same case recognized clearly that the "giving away" of liquor, to be unlawful, must be a giving away that is a subterfuge for a sale. 273 P. 2d at 157. See also *Findley* v. *State*, 11 Okl. Cr. 275, 145 Pac. 1107 (Okl. Cr. 1915).

Petitioners do not, however, imply that they are seeking to call upon the nine members of this Court to interpret the Oklahoma liquor laws. Both the District Court and the Court of Appeals in this case have recognized that the furnishing of liquor to social guests violates no local public policy; its conclusion that the drink becomes unlawful when the social guest is also a business client of the host is a rule spawned by a Federal Court which finds no explicit support in any pronouncement by the Oklahoma courts or by the Oklahoma legislature. The case is therefore one like *Lilly* v. *Commissioner*, 343 U. S. 90 (1952), where a Federal Court has attempted to deny a taxpayer a legitimate tax deduction on the basis of a local public policy which is not sharply defined and which exists only in the mind of the Federal Court. This presents a Federal question of substance well worthy of the attention of this Court, especially where the public interest in the outcome is as acute as it is here.

Petitioners desire to call the Court's attention to the dissimilarity between the instant case and the problems recently presented to the Court in *Hoover Motor Express Co.* v. *United States*, 356 U. S. 38 (1958), *Tank Truck Rentals, Inc.* v. *Commissioner*, 356 U. S. 30 (1958), and *Commissioner* v. *Sullivan*, 356 U. S. 27 (1958), in each of which the local public policy was clearly pronounced. The first two cases involved deductions for fines paid to the State for violation of criminal laws and the *Sullivan* case involved expenses incurred in the pursuit of clearly illegal gambling activities. Neither case bears on the problem presented here which is whether a Federal court

should, as a matter of Federal law, deny to a taxpayer an otherwise allowable income tax deduction on account of local public policies which are neither clearly delineated nor sharply defined by any local agency of government. While these cases do not solve the problem here presented it is interesting to note that had Mr. Winters been a bootlegger instead of a respectable member of the Bar, his claim of a deduction would be clearly allowable under the rationale of the *Sullivan* case.

When national laws, drafted to produce national revenues, are judicially interpolated or augmented by austere judges to serve as weapons for the enforcement of local policies and local moral codes it is essential to the preservation of respect for the revenue laws that the local policies be clearly and unequivocally expressed. Such is the clear mandate of *Lilly* v. *Commissioner, supra.* This salutory rule has been violated by the Court of Appeals in this case and the public is entitled to a review by this Court.

Respectfully submitted,

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APPENDIX.

Appendix A.

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OKLAHOMA

No. 4199, Civil

JOHN M. WINTERS, JR, and MARIAN M. WINTERS,
Plaintiffs,
vs.
THE UNITED STATES OF AMERICA,
Defendant.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This action having been tried upon the facts by the Court without a jury, the Court does hereby find the facts and state separately its conclusions of law thereon, and directs the entry of the appropriate judgment, as follows:

Findings of Fact

1. Plaintiffs are John M. Winters, Jr., and his wife, residents of Tulsa, Oklahoma, who filed with the Director of Internal Revenue for the District of Oklahoma a joint Federal income tax return for the calendar year 1954. Plaintiffs timely paid to such Director the tax shown to be due by said return.

2. John M. Winters, Jr. (hereinafter called "Taxpayer") is engaged in the general practice of law in Tulsa, Oklahoma, being a partner in the law firm of Conner, Winters, Randolph & Ballaine. By agreement, each partner is to bear personally all entertainment expenses incurred by each in the city of Tulsa which relate to firm business. During the calendar year 1954 Taxpayer spent $301.75 in the purchase of approximately four cases of liquor which was delivered to his home and consumed in his home during such year for entertainment which was appropriate and helpful in the retention and development of his law business. It is the usual practice in the City of Tulsa and in the State of Oklahoma for attorneys-at-law in the general practice to furnish liquor in connection with the entertainment of clients and prospective clients. Taxpayer claimed this $301.75 as a deduction from gross income in his 1954 income tax return; this amount was disallowed by the Internal Revenue Service on audit of the return.

3. During the month of August, 1954, certain plants at plaintiffs' residence in Tulsa, Oklahoma, died as the result of drought. Plaintiffs claimed on their 1954 income tax return $398.89 as a loss sustained thereby; this amount was disallowed by the Internal Revenue Service on audit of the return. The $398.89 represented the cost of replacement of the plants which had died. The loss was not compensated for by insurance or otherwise. The adjusted tax basis of Plaintiffs' residence and grounds is in excess of $30,000.00. The fair market value of plaintiffs' residence and grounds immediately prior to the death of the plants

exceeded $30,000.00, and such fair market value was reduced by at least $398.89 by reason of the death of such plants.

4. As the result of the disallowance by the Internal Revenue Service of the foregoing amounts (together with other determinations not involved in this proceeding) additional income tax in the amount of $1,839.69 was assessed against Plaintiffs for the calendar year 1954. Pursuant to such assessment plaintiffs on July 27, 1956, paid additional income tax for the calendar year 1954 in the amount of $1,839.69 and on the same date paid interest on such additional income tax in the amount of $138.10.

5. On October 5, 1956, plaintiffs filed with such Director a claim for refund of income tax for the calendar year 1954 in the amount of $483.4[illegible] and in said claim for refund also claimed refund of interest in the amount of $36.29. On March 4, 1957, such claim for refund was denied by registered mail.

Conclusions of Law

1. The purchase and possession of liquor in Oklahoma for personal use does not violate Oklahoma law. 37 Okl. St. Anno. Sec. 1 makes it unlawful to "sell, barter, give away or otherwise furnish" liquor, but the term "give away or otherwise furnish" is limited to a gift or furnishing which is a subterfuge for a sale. Findley v. State, 145 P. 1107 (1915); Dawson v. State, 273 P. 2d 154 (1954). The term "personal use" is not the equivalent of personal consumption; the concept of personal use includes the sharing of liquor with one's guests.

2. The purchase and possession and personal use of liquor in Oklahoma is not contrary to the public policy of the State of Oklahoma or the Federal government.

3. Revenue Ruling 55-307, 1955-1 Cumulative Bulletin 22, is erroneous in concluding that one who purchases liquor in Oklahoma "must be considered to have been a participant in a transaction proscribed by statute," and in concluding that expenditures for liquor purchased in Oklahoma for business promotion and entertainment purposes are not deductible business expenses.

4. The expenditure by Taxpayer of $301.75 in the purchase of liquor was an ordinary and necessary business expense of his, and therefore such $301.75 is deductible from his gross income under Section 162 of the Internal Revenue Code of 1954.

5. The death of certain plants at plaintiffs' residence during the month of August, 1954, was caused by

drought. Plaintiffs are entitled to deduct $398.89 from their gross income under Section 165 of the Internal Revenue Code of 1954 by reason of such loss.

It is so ordered and counsel for plaintiffs will submit appropriate judgment in accordance herewith.

Dated December 30, 1957.

Royce H. Savage,
United States District Judge

(Seal)

Filed January 2, 1958

Final Judgment After Trial by Court

This action came on to be tried before the Court, and the evidence adduced by the parties having been heard, and the Court having made its findings of fact and conclusions of law, it is hereby

Ordered, adjudged and decreed that plaintiffs recover of defendant the sum of Five Hundred Nineteen Dollars an Seventy-three Cents ($519.73) with interest at the rate of six per cent (6%) per annum from July 27, 1956.

Dated this 2nd day of January, 1958.

Royce H. Savage

Appendix B.

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 5902—September Term, 1958

Appeal from the United States District Court for the Northern District of Oklahoma.

UNITED STATES OF AMERICA, Appellant,

v.

JOHN M. WINTERS, JR., and MARIAN M. WINTERS, Appellees.

Filed November 13, 1958.

Meyer Rothwacks (Charles K. Rice, Assistant Attorney General, Lee A. Jackson and A. F. Prescott, Attorneys, Department of Justice, B. Hayden Crawford, United States Attorney, and Hubert A. Marlow, Assistant United States Attorney, were with him on the brief) for Appellant.
Roger S. Randolph (Horace D. Ballaine was with him on the brief) for Appellees.

Before MURRAH, PICKETT and BREITENSTEIN, Circuit Judges.

BREITENSTEIN, Circuit Judge.

The question is whether the cost of whiskey bought and used in Oklahoma by a lawyer for the entertainment of clients and prospective clients of the law firm in which he was a member is deductible as an ordinary and necessary business expense within the meaning of Section 162(a) of the Internal Revenue Code of 1954.

In their 1954 joint income tax return, appellees, John M. Winters, Jr., a Tulsa lawyer,[1] and his wife claimed as a deductible business expenses $301.75 spent for approximately four cases of whiskey delivered to taxpayer's home in Tulsa and used there for entertainment which the trial court found appropriate and helpful in the retention and development of the taxpayer's law business.[2] The trial court also found, and it is not contested here, that it is "the usual practice in the City of Tulsa and in the State of Oklahoma for attorneys at law in the general practice to furnish liquor in connection with the entertainment of clients and prospective clients." The deduction was disallowed, the additional tax paid, and suit brought to recover.[3] The court held that the deduction was proper and gave judgment against the United States.

The sole point raised on this appeal is that the allowance of the deduction would be a severe and immedi-

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1. Hereinafter referred to as taxpayer.

2. The gross legal fees received by the law partnership in 1954 were in excess of $300,000. The total amount claimed deductible by the taxpayer for business entertainment was approximately $2,350. The only portion of this which was disallowed was the $301.75 spent for whiskey.

ate frustration of the public policy of the state of Oklahoma and, hence, improper.

Deductions from gross income are a matter of congressional grace.[4] Section 162 of the Internal Revenue Code of 1954[5] allows as a deduction "all the ordinary and necessary expense paid or incurred during the taxable year in carrying on any trade or business." Entertainment expenses are not mentioned in the Code. To be deductible they must meet the test applied to business expenses generally, that is, the expenditures must be "directly related to the trade or business of the taxpayer."[6]

There is nothing in the 1954 Code or its predecessors prohibiting the deduction of ordinary and necessay business expenses which violate or frustrate public policy.[7] The disallowance of such expenses on public policy grounds has been established by the courts.[8] In Commissioner of Internal Revenue v. Heininger, 320 U. S. 467, 437, the Supreme Court recognized that the federal courts had narrowed the meaning of the language permitting the deduction of ordinary and necessary business expenses "in order that tax deduction consequences might not frustrate

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3. The suit also covered a disallowed deduction claimed under Sec. 165(c). The lower court ruled with the taxpayer on such deduction but that ruling is not involved in this appeal.

4. Commissioner of Internal Revenue v. Sullivan, 356 U. S. 27, 28.

5. 26 U. S. C., Sec. 162.

6. Knight-Campbell Music Co. v. Commissioner of Internal Revenue, 10 Cir., 155 F. 2d 827, 833; Mertens, Law of Federal Income Taxation, Rev. Ed., 1954, Vol. 4, Sec. 25.88.

7. Lilly v. Commissioner of Internal Revenue, 343 U. S. 90, 94.

8. Mertens, supra, Vol. 4, Sec. 25.131.

sharply defined national or state policies proscribing particular types of conduct" and went to to say that "the mere fact that an expenditure bears a remote relation to an illegal act" does not make it nondeductible. This decision was followed by Lilly v. Commissioner of Internal Revenue, supra, wherein the court, after quoting language from Heininger, said that the policies frustrated must be national or state policies evidenced by some governmental declaration of them.

During its October, 1957, term the Supreme Court decided three cases bearing on this question. They were Commissioner of Internal Revenue v. Sullivan, 356 U. S. 27, Tank Truck Rentals, Inc., v. Commissioner of Internal Revenue, 356 U. S. 30, and Hoover Motor Express Co., Inc., v. United States, 356 U. S. 38. The Sullivan decision requires the disallowance of a deduction if the allowance is "a device to avoid the consequence of violations of a law, * * * or otherwise contravenes the federal policy expressed in a statute or regulation."[9] The Tank Truck Rentals decision states that "the test of nondeductibility always is the severity and immediacy of the frustration resulting from allowance of the deduction."[10]

The question of nondeductbility because of frustration of public policy must be determined by the peculiar facts of each case.[11] While it will not be helpful to review the situations which have or have not resulted in a disallowance of claimed deductions because of frustration of

9 356 U. S. 29.

10. 356 U. S. 35.

public policy,[12] the litigated cases may be grouped into three major categories, viz.: where the expenditure is payment of a penalty for unlawful conduct,[13] where the expenditure is made in connection with an unlawful activity,[14] and where neither the expenditure nor the business in which it is incurred is unlawful but the allowance of such expenditure as a deduction would contravene public policy.[15]

The taxpayer asserts that the cost of liquor served in his home to clients and prospective clients of the law firm to which he belongs is an ordinary business expense as it accords with the usual practice of Tulsa lawyers and is a necessary expense to develop and retain the business of the firm. The government contests the deduction solely on the ground of frustration of public policy. It does not controvert the taxpayer's contention that the expenditure is directly related to his business. As the case is presented to us, if the expenditure does not frustrate public policy, the taxpayer is entitled to the deduction.

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11. Commissioner of Internal Revenue v. Heininger, supra, p. 473; Fuller v. Commissioner of Internal Revenue, 10 Cir., 213 F. 2d 102, 106.

12. A compilation of pertinent decisions is found in Mertens, supra, footnotes to Sec. 25.131. An earlier analysis of many cases appears in 54 Harvard Law Review 852, et seq.

13. Tank Truck Rentals and Hoover Motor Express, both supra.

14. Sullivan, supra. Cf. Cohen v. Commissioner of Internal Revenue, 10 Cir., 176 F. 2d 394, 400, where a distinction seems to be made between lawful and unlawful expenditures incurred in an unlawful business.

15. Cf. Textile Mills Securities Corp. v. Commissioner of Internal Revenue, 314 U. S. 326; Harden Mortgage Loan Co. v. Commissioner of Internal Revenue, 10 Cir., 137 F. 2d 282, cert. denied 320 U. S. 764.

The decision of this court in Finley v. Commissioner of Internal Revenue, 10 Cir., 255 F. 2d 128, 134, upholding the disallowance of the cost of whiskey as a business deduction of an Oklahoma taxpayer is not controlling because in that case the taxpayer did not deny that the transactions involving the whiskey were illegal in Oklahoma. In the instant case the taxpayer asserts that his purchase and use of the whiskey did not violate any Oklahoma law.

Oklahoma is a so-called dry state. In 1907 it adopted by vote of its people, and has since retained, as an amendment to its constitution a "prohibition ordinance."[16] Implementing legislation makes it unlawful to manufacture, import, transport, sell, barter, give away or otherwise furnish intoxicating liquors.[17] Possession of more than one quart of such liquor is made prima facie evidence "of an intention to convey, sell or otherwise dispose of such liquors."[18]

These constitutional and statutory provisions were re-examined in 1954 by the Criminal Court of Appeals in Oklahoma—the court of last resort in criminal matters—in the case of Dawson v. State, ... Okl. ..., 273 P. 2d 154. The defendant Dawson was charged with the unlawful possession of whiskey. Officers armed with a search warrant found eight pints of whiskey in his home. Evidence

16 O. S. 1951, Vol. 1, p. 135.
17 37 O. S. 1951, Secs. 1, 38, and 39.
18 37 O. S. 1951, Sec. 82.

for the defense was that he had the whiskey to loan to another individual and expected to receive back the same whiskey, or an equal amount. It was contended that possession of whiskey is lawful in Oklahoma unless there is an intention to sell. The court rejected the argument and affirmed the conviction. Among other things, the court said:[19]

"We have held in many cases that the possession of intoxicating liquor by an individual for his own personal use is not unlawful. * * * However, under the statute, that seems to be the only purpose for which intoxicating liquor might be possessed without violating some provision of the prohibitory laws. It seems readily apparent that at statehood the majority of the people of Oklahoma were in favor of a dry state and the Legislature enacted laws for the suppression of the traffic in intoxicating liquors in accordance with the wishes of a majority of the population. The legislation enacted in pursuance of that policy apparently intended to prohibit the possession of intoxicating liquor for every purpose except for the personal use of the possessor, and the possessor was not legally allowed to convey it from one place in the state to another place."

Thus, the highest Oklahoma court has said that the state policy is to prohibit possession of intoxication liquor for every purpose "except for the personal use of the possessor." In the instant case the United States District Court recognized this rule and held that "the concept of

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[19] 73 P 2d 159

personal use includes the sharing of liquor with one's guests." Such conclusion from the Oklahoma decisions is justified if it is confined to the serving of intoxicating liquor to social guests in the home of the individual who has the necessary possession. While this may seem paradoxical in view of the numerous unlawful acts which necessarily must precede such hospitality, we are bound to accept it as the policy of Oklahoma.

The difficulty is that the taxpayer's claim of deductibility is based on the fact that the liquor was possessed and used for business purposes. By agreement each partner in the firm to which the taxpayer belonged bore personally all entertainment expense incurred by him in Tulsa and relating to firm business. Thus the whiskey in question was used by the taxpayer to obtain a benefit for the partnership of which he was one member. He benefited only to the extent that his share of the partnership profit might be assured or increased.

A personal use of alcoholic liquors for the gratification of social guests is in a different category from the business use of such liquors for the attainment of commercial objectives. The record shows, and the trial court found, that it is the "usual practice" for Tulsa lawyers to furnish liquor when entertaining clients or prospective clients. This custom and usage does not change the policy of Oklahoma. That policy is made by the people who by their vote placed the prohibitory provisions in the state constitution and who, acting through their chosen legislators, are responsible for the implementing legislation.

There is and must be a distinction between an ordinary and necessary business expense which is deductible under Section 162 of the 1954 Internal Revenue Code and personal, living or family expenses which are made not deductible by Section 262 of the same code.[20] Indeed, the taxpayer himself has made this distinction because he did not claim as deductible other whiskey purchases made by him during the same year for the use of himself and his wife. Such distinction requires the conclusion that taxpayer's possession of the whiskey, the purchase price of which is claimed to be deductible, was not for the personal use of the possessor and hence was a violation of the state policy expressed in the state constitution and statutes and clearly defined by the highest court of the state.

The problem remains as to whether this frustration of state policy is so severe and immediate as to require the disallowance of the expenditure. This is not a case like either Tank Truck Rentals or Hoover Motor Express, supra, where the expenditures claimed as deductions were for fines paid on account of violation of state law. It is not a case like Sullivan in which the expenditure for a legitimate purpose was made in connection with the operation of an illegal business. It is more like Harden Mortgage Loan Co. v. Commissioner of Internal Revenue, supra, wherein expenditures for lobbying, though not illegal, were held to be nondeductible.

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20. 26 U. S. C., Sec. 262

Under Oklahoma law the act of purchase was not unlawful.[21] Probably no case will ever arise where deductibility is claimed for an expenditure which in itself is unlawful. However, the expenditure was for an illegal purpose, that is, to acquire possession of the whiskey for a purpose contrary to the Oklahoma statute.[22] The accomplishment of this illegal purpose required the importation of the whiskey into Oklahoma[23] in violation of 18 U. S. C., Sec. 1262 which makes a federal penal offense of the importation of intoxicating liquor into a state which forbids the sale thereof,[24] and also in violation of Oklahoma law.[25] The possession, conveyance and sale of the whiskey by taxpayer's vendor violated Oklahoma law. All of these illegal acts were necessary to the attainment of the objective of the taxpayer which was to develop and retain the business of the law partnership to which he belonged by entertainment which included the serving of alcoholic liquor. The severity of the frustration is not diminished by the fact that the purchase violated no Oklahoma law. The immediacy of the frustration is shown by the fact that a law violation directly preceded and directly followed the expenditure claimed to be deductible.

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21. Brown v. State, ... Okl. ..., 266 P. 2d 988, 990.

22. Cf. The Lorraine Corporation v. Commissioner of Internal Revenue, 33 B. T. A. 1158, 1166.

23. The whiskey was "bonded liquor" bearing "federal liquor stamps."

24. This statute applies to Oklahoma General Motors Acceptance Corp. v. United States, 10 Cir., 201 F. 2d 732, 734; Jones v. United States, 10 Cir., 258 F. 2d 81, 84.

25. 37 O. S. 1951, Sec. 501.

While the decision in this case is not controlled by Tank Truck Rentals, supra, where the claimed deductions represented fines paid for law violations, it also is not controlled by Sullivan, supra, where deductions for rent and expenses incurred in the conduct of an illegal business were allowed. In Sullivan the court pointed out that the treasury regulations permitted the deduction of the federal excise tax on wagers and that such policy "seems sufficiently hospitable to allow the normal deductions of the rent and wages" necessary to conduct the business. No such hospitality is shown in the instant case as federal law forbids the importation of the liquor into Oklahoma and a pertinent Internal Revenue ruling forbids the deduction.[26]

The situation with which we are confronted is unique. Oklahoma in its prohibiton of alcoholic liquors stands in almost solitary isolation.[27] That isolation does not detract from its right to establish and maintain a state policy of its own. The wisdom of the policy is for determination by the people of Oklahoma, not this Court. The United States Supreme Court has said that such state policy may not be frustrated by the allowance of deductions from federal income tax for expenditures which have a severe and immediate adverse effect thereon. The fact that the disallowance of such deductions will result in a "serious

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26. Revenue Ruling 55-307, 1955-1 Cumulative Bulletin, p. 22.

27. According to CCH Liquor Control Law Service the only states having statewide prohibition against alcoholic liquors are Oklahoma and Mississippi.

punitive consequence[28] which could not occur in other states is immaterial. We are concerned solely with Oklahoma and its policy. We are not concerned with the policy of another state or with what a small group would seek to establish as Oklahoma policy by a claim of custom and usage.

This is not a case of a taxpayer becoming innocently involved in an illegal transaction. Rather it is one where a taxpayer deliberately and knowingly patronized an illegal business. By reason of such patronage there was a severe and immediate frustration of state policy. This requires disallowance of the claimed deductions.

The judgment is reversed to the extent that it orders the recovery of any tax paid as the result of the disallowance of the deduction claimed for the whiskey expenditures.

MURRAH dissenting.

Admittedly, the decisive question is whether these expenditures, otherwise deductible as ordinary and necessary business expenses under Section 162a of the Internal Revenue Code of 1954, are nevertheless nondeductible in Oklahoma because they frustrate a sharply defined public policy of that state with respect to the sale or disposition of intoxicating liquor. While the deductibility of expenses incurred in this manner is concededly a matter of legislative grace, their nondeductibility in Oklahoma for

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28. Cf. Commissioner of Internal Revenue v. Heininger, supra, p. 474

reasons of public policy is assuredly a matter of judicial fiat. No considerations of national public policy forbid the deduction.

We know that not every business expenses which is in some way tainted with illegality is per se rendered nondeductible. Sullivan v. Commissioner, 356 U. S. 27. The test of nondeductibility is one of degree of the severity and immediacy of the frustration of a sharply defined public policy of a state. Tank Truck Rentals, Inc., v. Commissioner, 356 U. S. 30.

I agree with the distinguished Oklahoma trial judge that the allowance of the claimed deduction does not severely and immediately frustrate any sharply defined public policy of Oklahoma.

It is conceded that under Oklahoma law the purchase of the liquor was not a crime, and the expenditure sought to be deducted here was not itself unlawful. It is said, however, that the taxpayer here "deliberately and knowingly" patronized an illegal business resulting in a "severe and immediate frustration of state policy." The immediacy of the frustration is said to lie in the fact that "a law violation directly preceded and directly followed the expenditure claimed to be deductible." Nondeductibility is thus made to rest upon a critical interpretation of Oklahoma law to the effect that the furnishing of liquor to business guests is a violation of the prohibitory laws. Relying on Dawson v. State, 273 P. 2d 154, and allied cases, the majority draw a distinction between the pos-

session of liquor in Oklahoma for personal use and business purposes.

From these decisions it does indeed seem logical to conclude that the Oklahoma courts would sustain a criminal charge for serving intoxicating liquor to business guests in one's own home. It is significant for our purposes however, that as far as we know, no such charge has ever been reported in more than fifty years of prohibition in Oklahoma. It seems only fair to assume, therefore, that at the enforcement level, at least, the prohibition laws have not been construed so severely.

When the Oklahoma law is thus construed in the context of human conduct, it is extremely doubtful that the taxpayer has severely and immediately frustrated any very well defined public policy of Oklahoma with respect to the prohibition laws. As one living in the state since the very inception of the law, and as one claiming some acquaintance with the mores of the community, I certainly cannot say so.

This is not to say that the letter of the law is subordinate to its observance so that a law honored in its breach does not reflect public policy. It is to say that the law is interpreted not only by the courts, but also by the mores of the community wherein it is effective. Indeed, the people make the law, and by their conduct construe it to reflect the public policy of the state.

This transaction does not bear the stigmatism or the culpability of unlawful influence as in Finley v. Commis-

sioner, 255 F. 2d 128; Harden Mortgage Loan Co. v. Commissioner, 137 F. 2d 282; Cohen v. Commissioner, 176 F. 2d 394. Certainly when measured in degrees of frustration case by case, the frustration of state policy here is no more severe or immediate than the illegal expenditure for rent on a gambling establishment held deductible in Sullivan.

I would affirm the trial court.

Appendix C.

Relevant Statutes

Internal Revenue Code of 1954:

Sec. 162. *Trade or Business Expenses.* (a) *In General.* There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered.

(2) traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; * * *

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(26 U. S. C. 1952 Ed., Supp. II, Sec. 162)

37 Oklahoma Statutes Annotated (Permanent Ed.)

Sec. 1. *Manufacture, sale or furnishing—Alcoholic content — Transportation — Advertisements — Misdemeanor — Punishment — Exception of unfermented cider and wine.* It shall be unlawful for any person, individual or corporation to furnish, except as in this chapter provided, any spirituous, vinous, fermented or malt liquors, or any imitation thereof or substitute therefor, or to manufacture, sell, barter, give away or otherwise furnish any liquors or compounds of any kind or description whatsoever whether medicated or not which contain more than

three and two-tenths (3.2%) per cent of alcohol, measured by weight, and which is capable of being used as a beverage, except preparations compounded by any licensed pharmacist, the sale of which would not subject him to the payment of the special tax required by the laws of the United States; or to ship, or in any way convey, such liquor from one place within this state to another place therein except the conveyance of a lawful purchase as herein authorized; or to solicit the purchase or sale of any such liquors, either in person or by sign, circular, letter, card, price list, advertisement, or otherwise, or to distribute, publish, or display any advertisement, sign or notice where any such liquor may be manufactured, bartered, sold, given away, or otherwise furnished, or to have the possession of any such liquors with the intention of violating any of the provisions of this chapter. A violation of any provisions of this section shall be a misdemeanor, and shall be punished by a fine of not less than fifty dollars ($50.00) nor more than five hundred dollars ($500.00), and by imprisonment for not less than thirty (30) days, nor more than six (6) months: Provided, however, that the provisions of this chapter shall not only apply to the manufacture and sale of unfermented cider and wine made from apples, grapes, berries and other fruit grown in this State, and to the use of wine for sacramental purposes in religious bodies.

Sec. 31. *Unlawful possession of liquor containing 3.2 per cent of alcohol in place of business, etc.—Exceptions —Punishment.* It shall be unlawful for any person to have

or keep in excess of one quart of spirituous, vinous, fermented or malt liquors, or any imitation thereof, or substitute therefor, or in any manner permit any other person to have or keep, any spirituous, vinuous, fermented or malt liquors, or any imitation thereof, or substitute therefor, or any liquors or compounds of any kind or description whatsoever, whether medicated or not, which contain more than three and two-tenths (3.2%) per cent of alcohol measured by weight, and which is capable of being used as a beverage, except preparations compounded by any licensed pharmacist, the sale of which would not subject him to the payment of the special tax required by the laws of the United States; upon, in, or about his place of business, or any place of amusement, or recreation, or any public resort, or any club room, whether such liquor be intended for the personal use of the person so having and keeping the same or not. Provided however, that the foregoing provision of this section shall not apply to bonded apothecaries, druggists, pharmacists, scientific institutions, universities, colleges, and hospitals as to alcohol purchased by them pursuant to the rules and regulations promulgated by the Governor, in accordance with the provisions of this act. Provided, further, that this section shall not be construed, in any way to legalize the keeping of such liquors for an unlawful purpose. A violation of any provisions of this section shall be a misdemeanor and shall be punished by a fine of not less than fifty dollars ($50.00) nor more than five hundred ($500.00) dollars and by imprisonment for not less than thirty (30) days nor more than six (6) months.

Sec. 38. *Receipt of liquor from carrier or possession of liquor so received unlawful—Interstate and intrastate shipments—Punishment—Exceptions.* It shall be unlawful for any person in this State to receive directly or indirectly any liquors, the sale of which are prohibited by the laws of this State, from a common or other carrier.

It shall also be unlawful for any person in this State to possess any liquor, the sale of which are prohibited by the laws of this State, received directly or indirectly from a common or other carrier in this State. This section shall apply to such liquors intended for personal use, as well as otherwise, and to interstate as well as intrastate shipments or carriage. Any person violating any provision of this section shall be guilty of a misdemeanor, and upon conviction shall be fined not less than $50.00 nor more than $500.00 and by imprisonment for not less than thirty days or more than six months; Provided, however, that scientific institutions, universities and colleges, and bonded apothecaries, druggists, hospitals or pharmacists may receive and possess pure grain alcohol, as provided by the laws of this State, to be used only for such purposes as are prescribed by the laws of this State.

Sec. 50.1. *Importation or transportation without permit unlawful.* It shall be unlawful for any person, individual or corporate, to import, bring, transport, or cause to be brought or transported into the State of Oklahoma, any intoxicating liquor, as defined by the laws of this

State, containing more than four per cent (4%) of alcohol by volume, without a permit first secured therefor as hereinafter provided.

Sec. 50.2. *Permits authorized—Purposes—Bond* Permits may be issued, as in this Act provided, for such importation and transportation of alcohol for scientific or mechanical purposes by, and to such scientific institutions, universities and colleges as are authorized to secure the same free of tax under the laws of the United States, and alcohol by and to hospitals, and sanitariums for medicinal use in such hospitals and sanitariums, and for the importation and transportation of alcohol to and by an apothecary, druggist, pharmacist, or maufacturing agency, who shall need same for such purpose and, who shall have executed a bond to the State of Oklahoma, approved by the Tax Commission of the State of Oklahoma, in the sum of not less than One Thousand Dollars ($1,000.00), conditioned that none of said alcohol shall be used or disposed of for any purpose other than in the compounding of prescriptions or other medicines, or in such manufacturing business, the sale of which prescriptions, medicines, or manufactured products would not subject him or it to the payment of the special tax required of liquor dealers by the United States. Permits may also be issued for the importation and transportation, or causing to be imported or transported into this State, of wine for sacramental purposes. No permit shall be issued to any person, or for any purpose, or for the importation of any intoxicating liquor, except as specifically authorized under this Section.

Sec. 50.3. *Necessity of permit—Possession and exhibition—Return and cancellation—Negativing issuance or possession—Burden of proof—Prima facie evidence.* Any person, individual, firm, corporation, or association desiring to import, bring in, or transport intoxicating liquor, containing more than four per cent (4%) of alcohol by volume, shall first secure from the Tax Commission of the State of Oklahoma, a permit as herein provided. Such permit shall accompany such intoxicating liquor at all times while being imported, brought into and transported into and in the State of Oklahoma, shall be in possession of the person or carrier transporting the same and shall, upon demand, be exhibited to any peace officer or other duly constituted agent or representative of the State of Oklahoma, or such officer of the United States of America. When said intoxicating liquor shall have reached destination, such permit shall be returned to the said Tax Commission and by it marked "cancelled." In any complaint, information, indictment or other proceeding laid or brought under this Act it shall not be necessary to negative the issuance or possession of a permit, and the burden of establishing such issuance and possession shall be upon the person or party claiming the benefit thereof. Failure to produce and exhibit such a permit upon demand as provided in this Act, shall constitute *prima facie* evidence of the lack of such permit.

Sec. 50.4. *Application for Permit.* The application of such permit shall be in writing duly verified, upon a form approved by said Tax Commission, and shall include the

date, name of the applicant, name and location of the person, firm, or corporation from whom said intoxicating liquor is to be bought or procured, the kind, character, quality and quantity thereof, the purpose for which it is to be used, the date and amount of last importation, and amount remaining on hand; that applicant has never been convicted of violating the prohibitory liquor laws of the State of Oklahoma or of any laws of the United States, and that he has not sold or used, in violation of the laws of Oklahoma, any intoxicating liquor theretofore secured under the provisions of this Act. Said application must be verified by the applicant or by the president, vice-president, secretary, or manager of the corporation, association, or oganization making such application. Applications for permits for importation of wine for sacramental purposes shall be verified by a minister, priest, pastor, or duly authorized official of the church or organization for which such application is made.

Sec. 50.5. *Preparation, form and issuance of permit—Duration of validity.* The permit provided for by the terms of this Act shall be upon a form prepared by the Attorney General of the State and approved by the Tax Commission and shall be executed by the Tax Commission and attested by the Secretary of State under the seal of the State. It shall include the date, name of the applicant, name and location of the person, firm, or corporation from whom such liquor is to be bought or procured, the kind, character, quality and quantity thereof, and the purpose for which it is to be used. The application and

permit shall contain such additional provisions as may be prescribed by the said Tax Commission or by rules and regulations, not inconsistent herewith, as prepared by the Attorney General and then adopted by the Governor. Any such permit shall be valid and in effect for a period of fifteen (15) days from and after the date thereof. No permit shall be issued except upon the filing of a proper and sufficient application as provided by this Act, nor unless the said Tax Commission shall find that said application is in good faith and that such liquor is to be brought into the State for a lawful purpose, as herein defined. The execution of a permit by the Tax Commission shall be by a member of the Commision or by its chief clerk and the attestation of the Secretary of State shall be made a matter of permanent record in the office of the Secretary of State.

Sec. 50.6. *Violations—Punishment.* Any person violating any of the provisions of this Act shall be punished by a fine of not less than Fifty Dollars ($50.00) nor more than Two Thousand Dollars ($2,000.00) and by imprisonment of not less than thirty (30) days in the county jail nor more than five (5) years in the State penitentiary.

Sec. 82. *Possession of Specified Quantity as Prima Facie Evidence.* The keeping in excess of one quart of any spirituous, vinous, fermented or malt liquors, or any imitation thereof, or substitute therefor, or any liquor or compounds of any kind or description whatsoever, whether

medicated or not, which contain more than three and two-tenths (3.2%) per cent of alcohol measured by weight and which is capable of being used as a beverage, except preparations compounded by any licensed pharmacist, the sale of which would not subject him to the payment of the special tax required by the laws of the United States, or in any manner permitting any other person to have or keep any such liquors in or about his place of business or his residence, or any place of amusement, or recreation, or any public resort, or any club room; provided, however, that the foregoing provision of this section shall not apply to bonded apothecaries, druggists, or pharmacists, as to alcohol purchased by them pursuant to the rules and regulations promulgated by the Government in accordance with the provisions of the law of this State; or the keeping in excess of one quart of spirituous, or one quart of vinous, or more than one quart of any liquor or compounds of any kind or description whatsoever, whether medicated or not, which contain more than three and two-tenths (3.2%) per cent of alcohol, measured by weight and which is capable of being used as a beverage, except preparations compounded by any licensed pharmacist, the sale of which would not subject him to the payment of the special tax required by the laws of the United States shall be *prima facie* evidence of an intention to convey, sell or otherwise dispose of such liquors; provided further, that this section shall not be construed in anyway to legalize the keeping of liquors for unlawful purposes irrespective of the amount.